

FDIC State Profile

Spring 2005

California

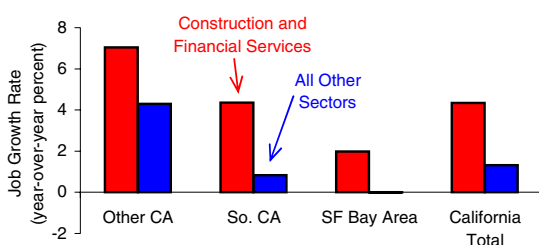
California job growth improved to 1.7 percent at year-end 2004, and further increases are expected in 2005.

- For the first time since 2001, the San Francisco Bay Area¹ economy added jobs despite weakness in *San Jose*.
- The professional and business services sector added the largest number of jobs in 2004 (62,400), with gains in *Los Angeles*, *Riverside-San Bernardino*, *San Diego*, and *Orange County*. The employment services subsector drove the growth.
- Although still well below peak levels, venture capital invested in California in 2004 posted the first year-over-year gain since 2000, led by strength in Silicon Valley and San Diego.
- The construction and financial services sectors also provided a boost during 2004, adding nearly 75,000 jobs. While these sectors accounted for only 12 percent of California's labor force, they added a disproportionately large share of net new jobs and may be particularly vulnerable to slowing as interest rates rise (See Chart 1).
- Government sector job cuts, resulting from the state's large budget deficit, continued to be the primary drag on overall growth. In addition to budget challenges, the state faces uncertainty about rising interest rates, the effect of a Chinese currency revaluation, military base relocation and closure, and reduced agriculture subsidies.

Housing price gains moderated in some areas.

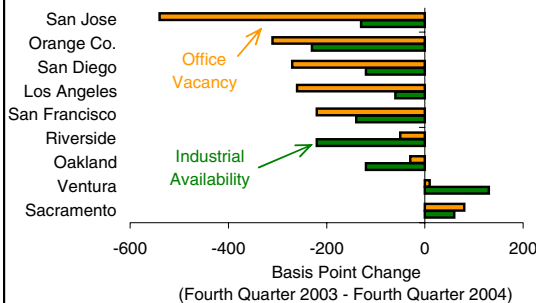
- Residential permit issuance in California reached a 15-year high in 2004. Permitting was especially strong in central and Southern California; *Yuba*, *Riverside*, *Calaveras*, *Mono*, and *Placer* counties issued permits at per-capita rates more than twice the national level.
- Annual home price gains topped 23 percent in fourth quarter 2004. Areas such as *Riverside-San Bernardino*, *San Diego*, and *Sacramento* reported even larger increases, further straining affordability. Home prices encouraged

Chart 1: The Construction and Financial Services Sectors Dominated Job Gains in California



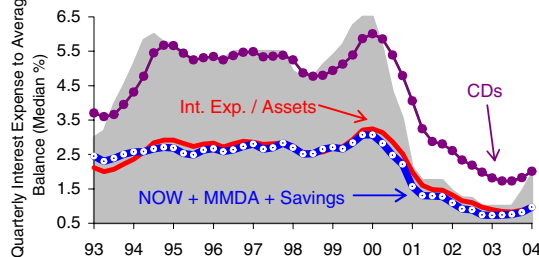
Note: So. CA = Los Angeles-Long Beach-Riverside Combined Statistical Area (CSA) and San Diego, Santa Barbara, and El Centro Metropolitan Statistical Areas (MSAs). SF Bay Area = San Jose-San Francisco-Oakland CSA.
Source: Bureau of Labor Statistics (data as of fourth quarter 2004)

Chart 2: Office and Industrial Market Conditions Improved in Most California Metropolitan Areas



Source: Torto Wheaton Research

Chart 3: Interest Expense Ratios in California were Kept Low by High Core Deposit Exposures



Note: Includes Call Report filers only. NOW is negotiable order of withdrawal; MMDA is money market deposit account; CD is certificate of deposit. Gray shaded area denotes average target Federal Funds rate for the quarter.
Sources: FDIC; Federal Reserve

¹The San Francisco Bay Area includes the San Francisco, Oakland, San Jose, Santa Rosa, and Vallejo metropolitan areas (MAs). Southern California includes the Los Angeles, Orange County, San Diego, Riverside-San Bernardino, Santa Barbara and Ventura MAs.

an increasing share of purchasers to use hybrid and adjustable-rate mortgages, which could leave borrowers vulnerable to interest rate increases.

- According to PMI Mortgage Insurance Company, there is at least a 30 percent probability of home price softening during the next two years in the Southern California, Bay Area, and Sacramento markets.
- The median concentration of 1-4 family loans to Tier 1 capital among all California-based institutions was 52 percent, but concentrations were more than five times higher among institutions holding over \$5 billion in total assets. Favorably, geographic diversification among larger institutions may help insulate them should home price appreciation slow in pockets of the state.
- Home equity lines of credit remained one of the fastest growing loan segments.
- Past-due residential mortgage levels remained low, reflecting the favorable interest rate environment and improving economic conditions.

Commercial real estate (CRE) conditions improved.

- Steady absorption of new construction led to continued strengthening in most of the state's office and industrial real estate markets in fourth quarter 2004. Every major market in the state reported declining year-over-year vacancy rates except Sacramento and **Ventura**, where absorption did not keep pace with completions (See Chart 2). Also, most markets reported increased rental rates.
- The median concentration of CRE² loans to Tier 1 capital among California-based insured institutions increased modestly to 435 percent as of fourth quarter 2004, the third highest concentration among the states. Median annual growth in the construction, multifamily, and nonfarm-nonresidential mortgage portfolios topped 33 percent, 23 percent, and 18 percent, respectively, during the year. Benign interest rates, strengthening economic conditions, and a high percentage of newer, relatively unseasoned loans, enabled more than half of the institutions based in the state to report a past-due CRE loan ratio of zero at year-end 2004.

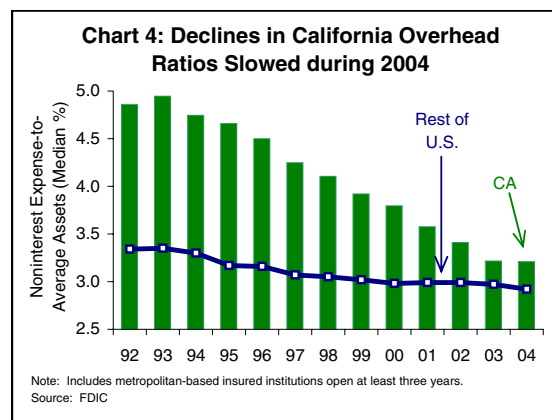
Bank funding costs face challenges in the near term.

- In late 2004, quarterly interest expense ratios among California-based banks increased modestly with rising short-term interest rates (See Chart 3). Funding costs have not yet fully incorporated recent short-term interest rate hikes and banks may have only a limited ability to lag increases in deposit costs as rates rise further.

- Nevertheless, high exposures to low-cost checking and savings accounts among California-based banks may soften the effect of rising interest rates on interest expense ratios. For instance, non-interest bearing checking accounts funded 19 percent of balance sheets on a median basis, compared with 12 percent nationwide. Importantly, certificates of deposit, which have traditionally been more rate-sensitive, funded 23 percent of California bank assets, versus 36 percent nationwide.

Earnings and asset quality performance was strong.

- The median year-to-date return on assets increased from 1.07 to 1.11 percent among California-based institutions, buoyed primarily by rising net interest income-to-average asset ratios. Short-term interest rate increases are likely to benefit California bank earnings because short-term, commercially-focused loan mixes may reprice faster or by a larger magnitude than funding bases.
- However, interest rate increases, combined with portfolio seasoning, could result in higher loan default activity and provision expenses, after reaching decade lows in 2004.
- Previously, overhead ratios benefited from merger and growth related efficiency gains and the confluence of lower problem loan costs, deposit insurance premiums, and goodwill amortization. However, improvements in overhead during 2004 were less dramatic than preceding years, especially among metropolitan-based institutions, a possible signal that significant efficiency gains may be difficult to realize prospectively (See Chart 4).



²CRE includes construction, multifamily, and nonfarm-nonresidential mortgages.

California at a Glance

ECONOMIC INDICATORS (Change from year ago quarter, unless noted)

Employment Growth Rates	Q4-04	Q4-03	Q4-02	Q4-01	Q4-00
Total Nonfarm (share of trailing four quarter employment in parentheses)	1.7%	-0.5%	-0.1%	-1.2%	3.4%
Manufacturing (11%)	0.2%	-4.7%	-5.9%	-8.9%	2.0%
Other (non-manufacturing) Goods-Producing (6%)	6.2%	3.8%	0.3%	2.4%	6.7%
Private Service-Producing (67%)	2.1%	0.3%	0.5%	-1.2%	3.5%
Government (16%)	-0.6%	-2.2%	1.6%	3.6%	2.9%
Unemployment Rate (% of labor force)	6.0	6.7	6.8	6.2	4.8

Other Indicators	Q4-04	Q4-03	Q4-02	Q4-01	Q4-00
Personal Income	N/A	4.7%	1.6%	1.1%	8.7%
Single-Family Home Permits	-2.4%	13.8%	28.5%	-7.9%	16.0%
Multifamily Building Permits	34.4%	12.1%	26.2%	6.8%	-3.5%
Existing Home Sales	-0.7%	8.6%	10.3%	-10.5%	-0.3%
Home Price Index	23.4%	14.6%	13.2%	10.8%	14.1%
Bankruptcy Filings per 1000 people (quarterly level)	0.75	0.91	1.05	1.06	0.98

BANKING TRENDS

General Information	Q4-04	Q4-03	Q4-02	Q4-01	Q4-00
Institutions (#)	295	318	325	343	350
Total Assets (in millions)	838,479	962,976	853,076	768,153	673,538
New Institutions (# < 3 years)	39	43	36	37	37
Subchapter S Institutions	23	22	18	14	12

Asset Quality	Q4-04	Q4-03	Q4-02	Q4-01	Q4-00
Past-Due and Nonaccrual Loans / Total Loans (median %)	0.29	0.59	0.72	1.00	0.87
ALLL/Total Loans (median %)	1.22	1.28	1.38	1.40	1.42
ALLL/Noncurrent Loans (median multiple)	3.21	3.21	2.81	2.32	2.95
Net Loan Losses / Total Loans (median %)	0.00	0.02	0.04	0.05	0.07

Capital / Earnings	Q4-04	Q4-03	Q4-02	Q4-01	Q4-00
Tier 1 Leverage (median %)	9.57	9.12	8.69	8.55	8.62
Return on Assets (median %)	1.11	1.07	1.08	0.97	1.11
Pretax Return on Assets (median %)	1.66	1.60	1.61	1.51	1.70
Net Interest Margin (median %)	4.37	4.39	4.62	4.72	5.27
Yield on Earning Assets (median %)	5.50	5.64	6.38	7.79	8.83
Cost of Funding Earning Assets (median %)	1.04	1.18	1.72	2.97	3.56
Provisions to Avg. Assets (median %)	0.14	0.15	0.20	0.20	0.22
Noninterest Income to Avg. Assets (median %)	0.58	0.67	0.68	0.69	0.71
Overhead to Avg. Assets (median %)	3.34	3.37	3.56	3.79	3.89

Liquidity / Sensitivity	Q4-04	Q4-03	Q4-02	Q4-01	Q4-00
Loans to Assets (median %)	70.0	67.4	68.9	68.1	67.3
Noncore Funding to Assets (median %)	20.7	20.4	20.2	21.2	20.4
Long-term Assets to Assets (median %, call filers)	14.1	17.3	13.5	12.7	12.5
Brokered Deposits (number of institutions)	106	101	104	88	86
Brokered Deposits to Assets (median % for those above)	3.1	3.3	3.6	3.7	2.7

Loan Concentrations (median % of Tier 1 Capital)	Q4-04	Q4-03	Q4-02	Q4-01	Q4-00
Commercial and Industrial	96.8	96.9	109.1	121.1	123.4
Commercial Real Estate	435.4	434.6	431.6	407.3	389.0
Construction & Development	68.3	55.1	60.7	63.1	49.7
Multifamily Residential Real Estate	20.6	15.2	16.2	13.2	13.7
Nonresidential Real Estate	266.8	269.2	275.3	253.9	237.6
Residential Real Estate	52.3	52.6	61.6	59.9	66.7
Consumer	6.3	8.5	12.8	15.1	16.9
Agriculture	0.0	0.1	0.1	0.0	0.3

BANKING PROFILE

Largest Deposit Markets	Institutions in Market	Deposits (\$ millions)	Asset Distribution	Institutions
Los Angeles-Long Beach-Santa Ana, CA	153	246,702	< \$250 mil.	155 (52.5%)
San Francisco-Oakland-Fremont, CA	83	154,040	\$250 mil. to \$1 bil.	76 (25.8%)
San Jose-Sunnyvale-Santa Clara, CA	48	47,229	\$1 bil. to \$10 bil.	54 (18.3%)
San Diego-Carlsbad-San Marcos, CA	67	43,813	> \$10 bil.	10 (3.4%)
Stockton, CA	24	36,847		